

SHELL OFFSHORE INC.

IBLA 97-120

Decided December 18, 1997

Appeal from a Decision of the Minerals Management Service denying a transportation allowance for drilling platform costs. MMS-94-0263-OCS.

Reversed.

1. Minerals Management Service: Generally--Minerals Management Service: Appeals to Director--Oil and Gas: Generally--Regulations: Interpretation

The fact that a compressor and other gas transportation equipment installed on a floating drilling platform required a defined increase in the platform's size entitled a Federal gas lessee to claim the enlargement was an integral part of a transportation system entitled to an allowance under 30 C.F.R. § 206.157.

APPEARANCES: Michael E. Coney, Esq., New Orleans, Louisiana, for Shell Offshore Inc.; Howard W. Chalker, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, DC, for Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE ARNESS

Shell Offshore Inc. (Shell), an affiliate of Shell Oil Company, has appealed from a September 9, 1996, Decision of the Acting Associate Director for Policy and Management Improvement, Minerals Management Service (MMS), denying a transportation allowance against the value of offshore natural gas production for royalty computation.

Shell claimed to be entitled to an allowance for part of the capital costs of the Auger drilling platform needed to support Shell's compressor and other machines used to move gas from the platform to market. The Auger platform, situated off the Louisiana and Texas coasts in the Gulf of Mexico, is called a "tension leg platform," and described as a "vertically moored, buoyant structural system where the excess buoyancy of the

platform maintains tension in the mooring system." (Statement of reasons (SOR) at 1; SOR Ex. C at 2.) The MMS Decision rejected Shell's claim for an allowance for platform costs, finding that MMS has never "approved an allowance for costs incurred by a lessee for offshore platform construction because such costs are necessary for production and marketing. There is no basis in the record to depart from that policy here." (Decision at 8, 9.)

The Auger platform and servicing gas line running to shore distribution installations are owned and operated by Shell Oil Company affiliates, so that 30 C.F.R. § 206.157(b)(2), governing transactions not conducted at arms length, applies here. See SOR at 3, 4; MMS Answer at 1.

In support of a claimed entitlement to include drilling platform costs in a transportation allowance, Shell explains that the Auger platform floats high over deep water; the importance of this fact is emphasized in affidavits from two Shell engineers submitted to establish the factual predicate upon which this appeal rests, which is that: "Unlike conventional fixed shelf structures, a tension leg platform is a buoyant floating structure which supports the weight of equipment load by hull buoyancy." (SOR Ex. B at 2 (Affidavit of David A. Huete).) It is further explained that because the platform floats like an anchored boat, "the Auger gas transportation facilities were a specific and direct part of the design requirements for the [platform]. The weight of these gas transportation facilities caused an increase in the size of the [platform]." (SOR Ex. A at 3 (Affidavit of Carl M. Webb III).)

Arguing that the platform could have been smaller and less costly without accommodations for the gas line equipment there in place, Shell contends that the MMS Decision denying the claimed allowance is inconsistent with undisputed facts stated by Shell's engineers concerning the unique nature of the floating platform; the SOR urges that "MMS has incorrectly implied a rationale associated with a fixed structure in shallow water to a floating [tension leg platform] located in deep water."

(SOR at 11.) Shell distinguishes fixed structures from the Auger platform, stating that the MMS position would be sustainable for those simpler platforms because "there is no added calculable incremental cost associated with furnishing [such a platform] since the structure is already designed for bearing and accommodating a drilling rig." *Id.* As a matter of fact, Shell states, the cost of additional space needed to float transportation equipment on the Auger platform (called "displacement" by Shell) can and should be allowed as part of the transportation allowance because of the causal connection demonstrated by the platform design as explained by Shell's engineers. (SOR at 15.)

Shell cites 30 C.F.R. § 206.156(a) in support of a contention that MMS may not deny transportation costs that have a reasonable basis in fact, but that, once reasonable actual costs are proved, "MMS must apply its own regulations [at 30 C.F.R. § 207.157(b)] to determine how much the allowance should be." (SOR at 12.) Shell concludes that "[e]very one of the items which caused the need for enhanced size and buoyancy has been specifically

found to be transportation related. To allege that the physical space needed to support, place and locate them is not 'integral' is factually preposterous." *Id.* Except for the pipeline itself, the other items mentioned by Shell include compressors, a riser skid, and extraction and dehydration equipment. All these other items were allowed by MMS for deduction.

The quoted use by Shell of the word "integral" refers to 30 C.F.R. § 206.157(b), the regulation relied upon by the MMS Decision to deny allowance of Shell's platform costs: The rule defines allowable capital costs, pertinently, as "costs for depreciable fixed assets (including costs of delivery and installation of capital equipment) which are an integral part of the transportation system." *Id.* The MMS also relies on this rule, arguing that the cost of enlarging the Auger platform to accommodate the compressor and other transportation equipment was not "integral" to the transportation system, as 30 C.F.R. § 206.157(b) requires if an allowance is to be made.

The MMS agrees that, under 30 C.F.R. §§ 206.156 and 206.157, a gas lessee is allowed a deduction for reasonable actual transportation costs. Nonetheless, the fact that a gas production system is in some way related to gas transportation does not, according to MMS, necessarily entitle a lessee to a deduction. An example given by MMS of such a cost that was not allowed appears in *Phillips Petroleum Co.*, 109 IBLA 4, 13 (1989), where the cost of constructing gathering lines to move gas to a central location to facilitate further transportation was disallowed. As noted by MMS, this holding followed *The Texas Co.*, 64 Interior Dec. 76, 80 (1957), another opinion that denied a royalty deduction after finding "the cost of gathering the gas from the wells and transporting it to the point of sale in the field is deemed to be one of the ordinary incidents of lease operation."

The MMS Decision rejected Shell's argument that costs reasonably linked to transportation could be credited as a transportation allowance; MMS found that "all costs incurred in the production phase of operations are borne by the lessee alone and are not chargeable against the lessor." (Decision at 6.) It was determined that Shell's drilling platform should "be capable of supporting all equipment needed for producing the gas and making it ready for market" and the cost of the platform was allocated to production rather than to transportation. (Decision at 7.) Finally, MMS found that platform costs have never before been treated as a reasonable actual transportation cost and refused to make an exception for the floating platform built in this case. (Decision at 8.)

The conflict between the positions taken by MMS and Shell poses the question whether MMS was correct in finding that Shell's drilling platform costs could not be deducted from royalty value under 30 C.F.R. § 206.157(b). The parties agree that the sole issue on appeal is whether some of the cost of building the Auger platform is deductible from royalty value.

[1] This is ultimately a question of fact. The parties agree that the rules at 30 C.F.R. §§ 206.156 and 206.157 apply in this case, and that costs are allowable if they are attributable to an integral part of a transportation system. In this case, the gas line running from the platform is conceded to be part of such a system, as are the compressor and associated equipment for which a deduction has already been allowed. It is accepted as fact that the Auger platform would have been smaller and less costly by a specifically calculated amount if the compressor and other transportation machinery were not required to be there. The effect of the equipment on the platform has been identified in terms of the water displacement it causes, and there is no other place to put the machinery; if it is to work, it must be kept on the platform. While MMS has not allocated drilling platform costs to transportation in the past, there is no showing that any prior drilling platform, in addition to providing a place to drill, also needed to be constructed and designed specifically to support an associated transport facility. Unlike the situation in the Phillips and The Texas Co. cases cited by MMS, the floating platform described by Shell's engineers is a construction that is clearly not one of the ordinary incidents of lease operation. It is a complex and unusual structure that must be evaluated for what it is.

The word "integral," used by the MMS rule defining allowable capital costs, is an adjective modifying the phrase "part of the transportation system." "Integral" is defined by The American Heritage Dictionary of the English Language, Houghton Mifflin Company (1976), to mean, "Essential for completion; necessary to the whole; constituent." Given the facts of this case, it is an inescapable conclusion that the cost of building additional buoyancy capacity to carry the transportation equipment fixed to the Auger platform was incurred for transportation purposes, and that the augmented platform buoyancy is an integral part of the Auger gas transportation system, the other parts of which have already been approved for allowance by MMS. Under the cited rules and consistent with prior cases cited by both parties, Shell is entitled to include the cost expended on the Auger platform needed to buoy the compressor and other transportation equipment as a reasonable actual transportation cost under 30 C.F.R. § 206.157(b)(2).

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Decision appealed from is reversed.

Franklin D. Arness
Administrative Judge

I concur:

C. Randall Grant, Jr.
Administrative Judge